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SUPREME COURT OF THE UNITED STATES

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OCTOBER TERM, 1951

No. 550

AUGUSTO R. SOLTERO,

Petitioner,

v.

SOL LUIS DESCARTES, TREASURER OF PUERTO RICO, ET AL.,

Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

May it please the Court:

The petitioner, Augusto R. Soltero, a sugar cane farmer, respectfully petitions this Honorable Court for a writ of certiorari to the United States Court of Appeals for the First Circuit.

Summary Statement of the Matter Involved

This case involves the validity of a particular post-mortem application of a Puerto Rican gross income tax statute to the "conditional payments" received by sugar growers and producers pursuant to the provisions of the

Sugar Act of 1937 (7 U.S.C.A. 1100 et seq.). The constitutionality of such tax imposition is contested on the ground that in substance and effect it is a burden or interference with a Congressionally devised method for stabilizing and fostering interstate and foreign sugar commerce and of preventing ruinous competition in it. Further, the taxing act is opposed on the ground that it unduly discriminates against individuals and in favor of artificial persons, imposing the levy exclusively on the "conditional payments" received by individual sugar farmers and producers while unjustifiably exempting from the tribute the same "conditional payments" when received by artificial persons engaged in exactly the same activity.

The petitioner grew sugar cane and ground it into sugar during the years 1942 to 1945. All the sugar thus produced was sold to Commodity Credit Corporation for shipment in interstate and foreign commerce. During those years there was a statute in force in Puerto Rico, denominated the Victory Tax Act,[1] which levied a 5% tax upon the gross income of every individual in the Island, in addition to the general net income tax. The Victory Tax Act was repealed in 1945, no attempt having been made to apply the levy to "conditional payments". But after the repeal, the Treasurer of Puerto Rico assessed tax deficiencies on the "conditional payments" received during the years 1942-1945 by all individual sugar growers and producers. Thus arose the present controversy, a test case affecting the interests of thousands of individual growers and producers.

After a trial on the merits, the insular Tax Court held that the conditional payments provided for in the Sugar Act constitute, if not totally, at least in part, a reimburse-

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[1] The act was originally enacted December 7, 1942 and was amended on May 10 and May 15, 1943. Its relevant sections are set out in the Appendix to the Brief in Support of this Petition.

ment to sugar cane producers, calculated by Congress to compensate them for the added expenses incurred in complying with the conditions set forth in Section 301 of the Act (R. 240-). As it had previously decided that income of this nature was not taxable under the terms of the Victory Tax Act, and since that statute specifically exempts all reimbursements, it entered judgment for petitioner (R. 241).

Upon review, the judgment was vacated by the Supreme Court of Puerto Rico and the case remanded to the Tax Court with specific instructions to decide "why the conditional payments . . . constitute . . . under . . . the Act, a reimbursement . . . of the expense incurred . . . by reason of the Sugar Act of 1937." (R. 244.) Additional instructions enjoined the Tax Court to decide, if necessary, the other questions presented by petitioner, "such as if the said payments are derived from a contract of sale; *whether the Victory Tax is void for unconstitutionality as applied to payments authorized by a federal statute;* and whether the Treasurer was authorized to collect the tax after Act No. 175 of 1943 was repealed." (R. 244.)

By stipulation, the case was re-submitted to the Tax Court on the record of the first hearing (R. 246). That Court found itself unable to determine upon the evidence "what portion of the so-called conditional payments corresponds to the reimbursement of the additional cost incurred by the petitioner" in complying with the pertinent provisions of the Sugar Act (R. 248), and, inexplicably ignoring the higher court's instructions as to the decision of the other questions involved, proceeded forthwith to enter judgment dismissing the complaint (R. 248-249).

The Supreme Court of Puerto Rico again granted certiorari. Extended briefs were filed on the constitutional questions posed and the parties orally argued the matter very thoroughly (R. 278). Surprisingly enough, however, the

Supreme Court of Puerto Rico affirmed the Tax Court's decision without deciding itself the constitutional questions involved, the very questions which it had explicitly instructed the Tax Court to consider and decide.

On appeal by petitioner, the United States Court of Appeals for the First Circuit affirmed the Puerto Rican judgment, stating that, although Congress has the power to annul the acts of the insular legislature, should their operation impinge upon interstate commerce, it had not annulled the Victory Tax Act, nor prohibited the Act's taxation of the conditional payments under the Sugar Act. It further indicated that "subsidies" (sic) somewhat like these payments are properly taxable *under the federal tax law,* and that "there is no clear and convincing evidence that this Victory Tax thwarts the Sugar Act of 1937 so as to defeat congressional policy" (R. 304). Finally, it held that the discrimination made by the act against individuals and in favor of artificial entities is not unreasonable, such distinction not being unusual in the federal tax structure (R. 305).

Three parts of the opinion of the Court of Appeals emphasize the issues here made by petitioner:—

1. That Court held that since Congress has the power to annul the acts of the insular legislature, the fact that it has not annulled the Victory Tax Act, nor prohibited that Act's taxation of the conditional payments under the Sugar Act, shows effectively that the taxing act does not impinge upon interstate commerce (R. 303-304). This ground of decision has repeatedly been disapproved by this Court.

2. The Court of Appeals further held that the tax sought to be applied in this case partakes more of the nature of a net income tax than of a tax on gross income or on gross receipts, in view of the deductions allowed, and that a tax on net income is not a burden on interstate commerce (R. 304). But the Court below overlooked the crucial fact that

this case does not involve the validity of the Victory Tax Act, already repealed. It only questions the constitutionality of a particular application of the statute, whereby the full tax is assessed on the total amounts received by petitioner as conditional payments. Thus, this application of the taxing act implies a tribute or levy on gross income or gross receipts.

3. The court below, in holding that the distinction made by the taxing act between individuals and artificial persons is not oppressive or discriminatory, indicated that such distinction is not unusual in the federal tax structure, and that it is conceivable that the Puerto Rican Legislature considered this tax measure as an anti-inflation device during the war period. But independently of the obvious fact that as an anti-inflation device the taxing act should have been made applicable both to natural and artificial persons, this Court has held that the imposition of a tax on the gross receipts of corporations operating a certain business, when it is not imposed upon individuals and partnerships engaged in the same business, unconstitutionally deprives corporations of the equal protection of the laws. And the converse of the proposition has also been approved by this Court.

This Court Has Jurisdiction

The jurisdiction of this Court is invoked under section 1254 of the Judicial Code (28 U.S.C.A. 1254). Judgment was entered in this case by the United States Court of Appeals for the First Circuit on November 8, 1951.

There is no question of local law here involved, nor of the power of the insular legislature, under the Organic Act of Puerto Rico, to levy or collect income taxes or any other tax. Petitioner attacks as unconstitutional a *particular application* of the Victory Tax Act which would materially reduce the amount of the conditional payments specifically

provided for by a Congressional enactment intended to regulate and foster interstate and foreign commerce.

The case thus involves an important question of federal law which has not been, but should be, settled by this Court. This Court, so far as petitioner is informed, has never decided whether a territory—or a State—may validly levy a gross income tax on the conditional payments provided for in the Sugar Act of 1937, thereby reducing the specific amount of such payments as prescribed by Congress.

The federal constitutional issues are properly preserved and the Court of Appeals passed on all of said issues.

The Questions Presented

1. Whether a Puerto Rican tax measured, in this particular application thereof, by the gross receipts of petitioner from the conditional payments provided for in the Sugar Act of 1937, is a burden on the scheme of regulation and stabilization of the foreign and domestic sugar market attempted to be set up by Congress through the enactment of the Sugar Act of 1937.

2. The issue is also presented as to whether Puerto Rico has the right, under the provisions of the equal protection clause of its Organic Act (48 U.S.C.A. 731 et seq) and of the Fourteenth Amendment, to assess a gross income tax on conditional payments received by individual sugar growers and producers, when the identical income received by artificial persons, like corporations, partnerships, successions, trusts, joint ventures, etc., is exempted from the tax, even though such artificial persons are engaged in the same activity and receive conditional payments from the same source, computed at the same rates and by the same methods, and paid upon compliance with the same conditions.

3. A final issue is also presented, i. e., whether Puerto Rico may validly levy an unapportioned gross income tax on

the proceeds of sales of sugar grown and produced by petitioner to be sold for immediate and direct shipment in interstate and foreign commerce, in compliance with regulations issued by the Secretary of Agriculture under the Sugar Act intended to assure the successful operation of the quota system prescribed in the Sugar Act.

Reasons Relied On for Allowance of the Writ

1. The decision of the Court of Appeals as to the validity of a local gross income tax applied to the conditional payments provided for in the Sugar Act of 1937 involves an important question of federal law which has not been, but should be, settled by this Court. Perhaps the question was intimated in *State Tax Commission* v. *Kennecott Copper Corporation,* 327 U. S. 573, 90 L. ed. 862, but no decision was made on the point at all.

In the Sugar Act Congress specifically provided for a payment of 80 cents per hundred pounds of sugar to producers who comply with the conditions set forth in that statute. This base rate was not loosely arrived at. It was the result of an extensive congressional investigation of costs of sugar production in the different producing areas supplying the domestic market, as well as of the economic impact of the sugar import duties. Puerto Rico is now seeking to uphold an application of its Victory Tax Act which would effectively reduce the payments from 80 cents per hundred pounds to 76 cents per hundred pounds. Should every state and territory levy a similar gross income tax on these payments, in differing rates and terms, it is easy to realize that the value of the conditional payments as "a Federal method of fostering interstate and foreign commerce and preventing ruinous competition in it" (House Report No. 1179, 75th Congress, First Session, Legislative Report of July 2, 1937) would be seriously impaired. Both the conditional pay-

ments and the quota system, set up in the Sugar Act as the two controlling media or instruments to carry into effect the declared policy of Congress as to the orderly marketing of sugar in foreign and interstate commerce, would be palpably affected.

2. The decision of the Court of Appeals as to the taxing act's discrimination between individuals and artificial persons, by holding that such discrimination is not oppressive nor unreasonable, is a decision of a federal question in a way probably in conflict with applicable decisions of this Court. In *Quaker City Cab Co.* v. *Pennsylvania,* 277 U. S. 398, 72 L. ed. 927, this Court stated with reference to such discrimination that "In no view can it be held to have more than an arbitrary basis." (277 U. S. at p. 402.) And in *Frost* v. *Corporation Commission,* 278 U. S. 515, 73 L. ed. 483, this Court warned that "A classification which is bad because it arbitrarily favors the individual as against the corporation cannot be good when it favors the corporation as against the individual." (278 U. S. at p. 522.)

Respectfully submitted,

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Petitioner,

vs.

SOL LUIS DESCARTES, TREASURER OF PUERTO RICO, ET AL.,

Respondents

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinion Below

The opinion of the United States Court of Appeals for the First Circuit is reported in 192 F. (2d) . The opinion is also printed in full in the Record, pp. 296-305.

Jurisdiction

The jurisdiction of this Court is invoked under section 1254(1) of the Judicial Code (28 U.S.C.A. 1254). The Court of Appeals has in this case decided an important question of federal law which has not been, but should be, settled by this Court. Further, the Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of this Court.

Judgment was entered in this case by the Court of Appeals for the First Circuit on November 8, 1951 (R. 306).

Statement of the Case

Petitioner, a grower and producer of sugar in Puerto Rico, has during the last thirteen years (R. 16) ground and processed his cane into sugar at a mill near San Juan pursuant to an agreement whereby the mill gets thirty-five per cent of the sugar so obtained (R. 47, 189). The remaining sixty-five per cent belongs to petitioner and is customarily left at the mill with instructions that it be sold to Commodity Credit Corporation, a corporate agency of the United States (R. 17, 18, 37, 50). All of petitioner's sugar has been so sold during at least ten years (R. 53-54).

Inasmuch as all the sugar thus produced during the years 1943-45 was sold to Commodity in conformity with the provisions of the Sugar Act of 1937 (7 U.S.C.A. 1100 et seq.), petitioner received the basic contractual price plus the conditional payments provided for in said statute. Accordingly, during those years petitioner was paid not only the contractual basic minimum price of $3.46 per hundred pounds, but also the further sum of 80 cents per hundred pounds of sugar marketed.[1] (Plaintiff's Exhibits 1-3, admitted at R. 18-20.) These payments were made to him upon applications certifying, among other data, the sugar commercially recoverable from sugar cane marketed or processed during those crop years by petitioner, the sugar actually produced pursuant to Sugar Determination No. 190, issued by the War Food Administrator on April 11, 1944, and the tonnage of sugar cane marketed for sugar (Plaintiff's Exhibit 1, R. 89).

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[1] 7 USCA 1134, as amended December 26, 1941, 55 Stat. 873. Prior to 1941 this payment amounted to 60 cents per hundred pounds, 50 Stat. 911.

Title III of the Sugar Act prescribes several conditions which must be complied with by producers to entitle them to the payments. Child labor is prohibited, laborers must be paid the wages determined by the Secretary of Agriculture, and certain farming practices must be carried out in connection with the production of sugar cane, including the planting of certain food crops and the application of soil erosion preventive measures. Of particular importance here is the specific requirement that there shall not have been marketed or processed an amount of sugar cane used for the production of sugar in, or so as to compete with or otherwise directly affect, interstate or foreign commerce in excess of the proportionate share for the farm as determined by the Secretary of Agriculture (7 U.S.C.A. 1131c).

Petitioner complied fully with all the statutory conditions and payments amounting to $881.17 in 1942, $1389.45 in 1943, and $1224.72 in 1944 were duly made to him by the Secretary (R. 87, 94-95).

During those years there was a statute in force in Puerto Rico which levied a 5% tax upon the gross income of every individual in the Island.[2] But during all the time the act was in force, the Treasurer did not construe it as applicable to the conditional payments authorized by the Sugar Act. Accordingly, no attempt was made during that time to levy or collect the tax on said payments (R. 84).

On May 15, 1945 the statute was repealed (Laws of Puerto Rico, 1945, p. 1265), and four months later petitioner was directed to file additional returns for, and to pay the tax on, the amounts received in the years 1943-45 as conditional payments (R. 228-229). Upon his refusal to do so, the Treasurer assessed deficiencies in the 1943-45 taxes con-

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[2] This tax was denominated "the Victory Tax." It was originally enacted on December 7, 1942 and subsequently amended on May 10 and May 15, 1943. (Laws P.R., 1942, No. 29; Laws P.R., 1943, pp. 146 and 630.) The relevant sections of the Act are set out in the Appendix.

sisting exclusively of the unpaid tax on conditional payments, with interest and penalties. Petitioner's motion for reconsideration was administratively denied and this proceeding was then initiated in the Tax Court of Puerto Rico.

After a trial on the merits, the insular Tax Court held that the conditional payments constitute, if not totally, at least in part, a reimbursement to sugar cane producers, calculated by Congress to compensate them for the added expense incurred in complying with the conditions set forth in Section 301 of the Act (R. 240). As it had previously decided that income of this nature was not taxable under the terms of the Victory Tax Act, and since that statute specifically exempts all reimbursements, it entered judgment for petitioner (R. 241).

Upon review, the judgment was vacated by the Supreme Court of Puerto Rico and the case remanded to the Tax Court with specific instructions to decide "why the conditional payments . . . constituted . . . under . . . the Act, a reimbursement . . . of the expense incurred . . . by reason of the Sugar Act of 1937." (R. 244.) Additional instructions enjoined the Tax Court to decide, if necessary, the other questions presented by petitioner, "such as if the said payments are derived from a contract of sale; *whether the Victory Tax is void for unconstitutionality as applied to payments authorized by a federal statute;* and whether the Treasurer was authorized to collect the tax after Act No. 175 of 1943 was repealed." (R. 244.)

By stipulation, the case was re-submitted to the Tax Court on the record of the first hearing (R. 246). That court found itself unable to determine upon the evidence "what portion of the so-called conditional payments corresponds to the reimbursement of the additional cost incurred by petitioner" in complying with the pertinent provisions of the Sugar Act (R. 248), and inexplicably ignoring the higher court's in-

structions as to the decision of the other questions involved, proceeded forthwith to enter judgment dismissing the complaint (R. 248-249).

The Supreme Court of Puerto Rico granted certiorari. Extended briefs were filed on the constitutional questions posed and the parties argued the matter very thoroughly (R. 278). Surprisingly enough, however, the Supreme Court of Puerto Rico affirmed the Tax Court's judgment *without deciding itself the constitutional questions involved,* the very questions which it had explicitly instructed the Tax Court to consider and decide.

On appeal, the United States Court of Appeals for the First Circuit affirmed. It held, in substance, that there is no evidence that the Puerto Rican Victory Tax Act thwarts the Sugar Act of 1937 so as to defeat congressional policy; that the act's discrimination between individuals and artificial persons is not unusual in the federal tax structure and is thus not unreasonable; and that, since Congress, having the power to do so, has not annulled the insular taxing act, it could not hold that said act's operation impinged upon interstate commerce (R. 303-305).

There is no doubt that (1) your petitioner grew sugar cane and produced sugar exclusively for direct and immediate shipment in interstate and foreign commerce; (2) that in the cultivation of the cane and in the production of its resultant sugar, petitioner was subject to, and actually fully complied with, all the conditions or requisites set forth by Congress in Title III of the Sugar Act of 1937; (3) that in consequence thereof, petitioner received certain sums of money as conditional payments under the Sugar Act; (4) that the fiscal authorities of Puerto Rico are now endeavoring to collect from petitioner a full 5% of said sums in an attempted post-mortem application of the Victory Tax Act, the tax being laid upon the total amount of the conditional

payments received by petitioner; and (5) that the tax is not levied on, nor attempted to be collected from, any other growers or producers operating as artificial persons, viz, from corporations, partnerships, trusts, joint ventures, successions, etc., even though such artificial entities are engaged in the same activity and consequently received conditional payments under the Sugar Act.

Your petitioner takes the position that by the tax discrimination thus made the equal protection of the laws is denied to him and to all other individual growers and producers of sugar in Puerto Rico; that the particular application here sought to be validated of the insular tax enactment, by taking for the use of Puerto Rico a part of every dollar allotted by Congress to sugar producers in exchange for the restricted marketing of their sugar, produced under onerous conditions required by the federal statute, is a burden or interference with the exertion of national power represented by the Sugar Act of 1937; and, finally, that the application of this gross income tax to petitioner's proceeds from interstate commerce would result in an unconstitutional burden on said commerce.

Errors Relied Upon

1. The United States Court of Appeals for the First Circuit erred in holding that the Puerto Rican Victory Tax, fully applied to the conditional payments received by individual sugar growers and producers under the Sugar Act of 1937, does not burden interstate commerce.

2. The court further erred in holding that such application of the Puerto Rican tax to conditional payments does not prejudicially interfere with the system of quotas and conditional payments set up by Congress in the Sugar Act of 1937.

3. The court further erred in upholding the constitutionality of the Puerto Rican taxing act's discrimination against individuals and in favor of artificial persons.

Argument

Summary of Point I

"The Puerto Rican Victory Tax Act, by its terms and as construed by the Supreme Court of Puerto Rico, levies a 5% tax on gross income. Although the act allows certain limited deductions, as pointed out by the Court below, the same are inoperative in this particular application of the statute because the full tax is here being assessed on the total amount of the conditional payments received by petitioner, save for a small exemption in the sum of $15.05 per week. (R. 266) The conditional payments on which such tax is laid are part of the total proceeds of petitioner's sugar sold for direct shipment in interstate and foreign commerce. Consequently, the application of such gross income tax to appellant's proceeds from interstate commerce would result in an unconstitutional burden or interference with said commerce."

Point I

The taxing act lays a tax of 5% "upon the gross income of every individual" in excess of a minimum amount ($15.05) per week. (R. 297) It, therefore, literally taxes gross income. And the Supreme Court of Puerto Rico has so construed the act: *Buscaglia* v. *Tax Court*, 69 P. R. Rep. 93, 105-106. Consequently, it hardly behooves the Court of Appeals below to hold, as it did (R. 304), that the exaction more closely resembles a net income tax. *De Castro* v. *Board of Commissioners*, 322 U. S. 451, 88 L. ed. 1384.

But the court below intimates further that in any event the Commerce Clause does not affect Puerto Rican legislation and that it "can have no consequential effect of

limiting territorial action" (R. 303) since Congress already has the power, under Article IV, Section 3, Clause 2 of the Constitution, to limit such action to any extent it chooses.

It is, of course, a well known constitutional doctrine that the Commerce Clause does not *ex proprio vigore* extend to the territories. But the emphasis lies in the phrase "*ex proprio vigore.*" " . . . the Constitution does not, *without legislation and of its own force,* carry such right to territory so situated."; *Dorr* v. *United States,* 195 U. S. 138, 49 L. ed. 128. See also *Hooven & Allison Co.* v. *Evatt,* 324 U. S. 652, 674, 89 L. ed. 1253, 1268. In other words, in the absence of legislation the Commerce Clause is applicable only to States and hence it does not automatically bar territorial legislation which might otherwise fall under its ban.

But Congress may extend the clause to apply to territorial legislation. It may, under the "needful rules and regulations" clause of the Constitution (Art. IV, Sec. 3, Cl. 2) limit territorial action to any extent it chooses. *Buscaglia* v. *Ballester Hermanos,* 162 F. (2d) 805, 807; *Sancho* v. *Bacardi Corporation of America,* 109 F. (2d) 57, 62.

In the particular field with which we are now concerned, —regulation of the marketing of sugar in interstate and foreign commerce,—Congress has extended the Commerce Clause's "secondary effect of a restriction upon the power of the States" [3] to Puerto Rico. The Sugar Act is a measure "to regulate commerce among the several States, *with the Territories and possessions of the United States,* and with foreign countries . . ." 50 Stat. 903. (Italics added.) The approval of this statute and its express application to Puerto Rico (See 50 Stat. 912), determined by Congress, operates as an extension to Puerto Rico of the implied prohibitions of the Commerce Clause. Therefore, at least in the field of sugar production and commerce, Puerto Rico

[3] *Buscaglia* v. *Ballester Hermanos, supra,* at page 807.

is no more at liberty to enact laws obstructing or burdening interstate commerce than are the forty-eight states of the Union. It certainly would be inconceivable that, in the face of a Congressional enactment regulating sugar commerce among the States, Territories and Possessions, the latter should be free to pass any local laws burdening or impeding such commerce.

Petitioner's position is, thus, that while the Commerce Clause does not *of itself* extend to Puerto Rico, its prohibitions have been extended to this territory by virtue of the approval by Congress of the Sugar Act of 1937, a measure enacted under the powers reserved to Congress by the Commerce Clause and made expressly applicable to Puerto Rico under the power of Congress to make all needful rules and regulations respecting the territories.

The question now before this Court is, thus, whether Puerto Rico may validly levy an unapportioned gross income tax on the proceeds of sales of sugar grown and produced by petitioner to be sold for immediate and direct shipment in interstate and foreign commerce.

The economic background of the Sugar Act clearly shows that Congress intended it to be primarily a measure to stabilize the sugar industry.[4] Such objective is effectuated through the establishment of quotas and the provisions for making conditional payments to producers. And inasmuch as an essential purpose of the declared policy of the Act is to restore the purchasing power of farmers to a parity level with other producers (7 U. S. C. A. 602), it would seem quite clear that the payments therein provided for constitute in substance and effect an additional price paid for the sugar produced. Indeed, such was the official interpretation; Plaintiff's Exhibit 24, admitted at R. 82.

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[4] See "The Sugar Act of 1937", 47 Yale Law Journal 980.

Further, the relevant statutory provisions point to these payments as effective additions to the price paid to producers for their product. No payment can be made unless the producer markets his sugar; Section 301c. The payments are computed on sugar, raw value; Section 304. And raw value is defined in terms of the recognized standard used to fix the commercial price of sugar in the market, namely 96 sugar degrees by the polariscope; Section 101h.

Practical considerations are also indicative of the effect of these payments. In return for the sugar produced and marketed, the producer actually gets the basic minimum contractual price *plus* the amount of the conditional payments. The conditions upon which the payments are made (Child labor prohibition, payment of prescribed wages, crop restriction, and certain farming practices), ineludibly imply added production costs, later recovered through receipt of the payments which, accordingly, are an effective and substantial part of the returns obtained by the producer from the sale of his sugar.

It is elementary that a state can neither lay a tax on the act of engaging in interstate commerce, *nor on gross receipts therefrom. East Ohio Gas Co.* v. *Tax Commission,* 283 U. S. 465, 75 L. ed. 1171. Such tax operates to lay a direct burden upon every sale in commerce by withholding for the use of the state a part of every dollar received from such sale. *Crew Levick Co.* v. *Pennsylvania,* 245 U. S. 292, 62 L. ed. 295. In the present attempted application of the Victory Tax, Puerto Rico is seeking to lay a gross income tax on an amount of money which petitioner received from the Secretary of Agriculture in return for his marketing of sugar in interstate commerce, a sale made under the provisions of a federal statute enacted as a regulation of commerce among the states and territories. Of course, a state may tax the money actually within its jurisdiction after it

has passed the stage of compensation or proceeds of a sale, but it does not follow that it may validly levy a gross income tax on the proceeds of these sales. *Fargo* v. *Stevens,* 121 U. S. 230, 30 L. ed. 888; *Cook* v. *Pennsylvania,* 97 U. S. 566, 24 L. ed. 1015.

Needless to say, the indication of the court below to the effect that "subsidies somewhat like these payments were properly taxable under the federal tax law" (R. 304) completely misses the point relative to the constitutional prohibition of *state taxes* which directly burden interstate commerce. Further, that indication fails to notice that the tax here involved is one on gross income while the federal income tax law levies a tax on net income.

Perhaps it should now be stressed that we are dealing with a gross income tax, which, in contrast with ordinary net income taxes, tends to place a proportionately heavier burden upon individuals who suffer losses or have a low ratio of net to gross earnings. Although net income taxes do not burden interstate commerce in a non-permissible way, *Cf. Western Live Stock* v. *Bureau of Revenue,* 303 U. S. 250, 82 L. ed. 823, certainly local taxes measured by gross receipts from interstate commerce have quite consistently been pronounced unconstitutional. *Gwin, White & Prince* v. *Henneford,* 305 U. S. 434, 83 L. ed. 272; *Matson Navigation Co.* v. *State Board of Equalization,* 297 U. S. 441, 80 L. ed. 791; *Fisher's Blend Station* v. *Tax Commission,* 297 U. S. 650, 80 L. ed. 956. And the mere fact that the local levy does not discriminate against interstate commerce, or in actuality or by possibility subject it to the cumulative burden of multiple exactions, does not show that such tax is valid, nor that it does not unconstitutionally burden or obstruct interstate commerce. *Joseph* v. *Carter & Weekes S. Co.,* 330 U. S. 422, 91 L. ed. 993. It may not be amiss to note here that petitioner is liable also for the general income

and ad valorem taxes of Puerto Rico, and, thus, that the present exaction is not in lieu of any other taxes. As a matter of fact, in this particular attempted application of the taxing act, Puerto Rico seeks to impose the tribute *exclusively* on that income which was received by petitioner as a consequence of producing, selling, and marketing sugar in interstate commerce in compliance with all the conditions prescribed in a federal enactment.

The all-important difference between a gross receipts tax and one measured by net income, from the standpoint of their effect on interstate commerce, was early adverted to by this Court:—*United States Glue Co.* v. *Oak Creek,* 247 U. S. 323, 62 L. ed. 1135. Such difference affords a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental.

For the purposes of the present discussion the fact that the court below described this tax as more closely resembling a net income tax can have no material significance because such characterization is plainly erroneous, inasmuch as the Victory Tax is a gross income tax. We are not, however, concerned here with descriptive labels. Whether the particular application of the tax enactment here attempted violates the commerce clause depends not upon labels, but upon the incidence of the tax, *Spector Motor Service* v. *O'Connor,* 95 L. ed. (Adv. Op.) 435, and the tax is here sought to be laid exclusively upon payments received by petitioner as part of the proceeds of sugar produced for, and sold in, interstate commerce. Accordingly, the tax in this specific instance incides directly into petitioner's gross receipts from interstate commerce. *Freeman* v. *Hewitt,* 329 U. S. 249, 91 L. ed. 265.

In disposing of this point, the court below seems to have been heavily influenced by the consideration that Congress,

although having the power to do so, "has not acted to annul the Victory Tax Act nor has Congress prohibited the Act's taxation of the conditional payments under the Sugar Act." (R. 304.) Such circumstance, of course, can have no compelling significance. Congress has *never* exercised its power to annul Puerto Rican statutes. Yet many insular enactments have been declared unconstitutional, even by the court below itself. For a recent example, see *Rivera* v. *R. Cobian Chinea & Co.*, 181 F. (2d) 974 (1950). Furthermore, this Court once admonished that "To justify the conclusion that Congress has consented to the violation of one of its own acts of such fundamental character, will require something more than such inaction upon its part as really amounts to nothing more than a failure affirmatively to declare such a violation by a formal act." *Springer* v. *Philippine Islands*, 277 U. S. 189, 72 L. ed. 845, 852.

It is, therefore, respectfuly submitted that this specific application of the Puerto Rican 5% gross income tax to conditional payments received by petitioner as part of the total proceeds from the sales of his sugar for direct shipment in interstate commerce, pursuant to the provisions of the Sugar Act of 1937, is invalid as a non-permissible restraint or burden on such commerce.

Summary of Point II

"The Congress of the United States is empowered by the Constitution to regulate commerce with foreign nations and among the several states. That authorization and the laws enacted pursuant thereto are supreme, and, in case of conflict, they control state and territorial enactments. The states and territories may not burden or interfere with the exertion of national power or make it a source of revenue. The Sugar Act of 1937 embodies a Congressional scheme of regulation having as its primary objective the stablization of the sugar producing, refining and importing industries. This

over-all objective is effectuated through the establishment and use of quotas under which the United States market is divided among the various domestic sugar-producing areas and certain foreign sugar-producing areas. As a means of implementing the sugar quotas authorized to be established, provision is made for making payments to domestic producers. Conditional payments are, thus, no different in their principle from a tariff applied to imports. Both constitute a Federal method of fostering interstate and foreign commerce and preventing ruinous competition in it. Consequently, a gross income tax on the total amount of said payments operates to actually withhold for the use of Puerto Rico a part of every dollar allotted by Congress to sugar producers in exchange for the restricted marketing of sugar produced under specific conditions enumerated by the federal statute, and, in substance and effect, is a burden or intereference with the exertion of national power represented by the Sugar Act."

Point II

In sustaining the validity of the Agricultural Adjustment Act of 1938, this Court pointed out that one of the primary purposes of that act was to increase the market price of the commodities regulated and to that end to limit the volume thereof that could affect the market. *Wickard* v. *Filburn*, 317 U. S. 111, 87 L. ed. 122, 137. Similarly, in upholding the quota provisions of the Sugar Act of 1937, the Court of Appeals for the District of Columbia adverted to the fact that "the very foundation stone of the Sugar Act is the prohibition or restriction of otherwise legitimate economic activity,—the marketing of sugar beyond the amount of the quota." *Gay Union Corporation* v. *Wallace*, 112 F. (2d) 192, cert. den. 310 U. S. 647, 84 L. ed. 1414.

Under Title III of the Act, payments are authorized to be made on several conditions. Since the main objective of the statute is to stabilize the sugar industry by limiting the

volume thereof that could affect the domestic sugar market, one of the essential conditions calls for a restriction of the amount of sugar marketed in interstate commerce by each producer. (Section 301c.) Other conditions require payments of the particular wages determined by the Secretary of Agriculture, proscription of child labor, and specific farming practices for improving the fertility of the soil and preventing erosion. All of them imply added expenses and, of course, higher production costs. The payments subsequently made are intended to actually raise the effective price of the product and thereby to compensate for the additional expenses incurred in meeting the conditions demanded.

Thus, the conditional payments, as well as the quota system, set up in the statute are the two controlling media or instruments devised to carry into effect the declared policy of Congress as to the orderly marketing of sugar in interstate commerce. The payments are, as much as the quotas, a vital integrant part of the statutory method designed by Congress to procure the stabilization of the flow of sugar in interstate and foreign commerce. Such, at least, was the legislative intention:—

> "Conditional payments are no different in principle from a tariff applied to imports. Both constitute a Federal method of fostering interstate and foreign commerce and preventing ruinous competition in it. If the sugar producer receives a reasonable return for his commodity, the market is stabilized, and if coupled with that, the consumer is not subjected to undue or additional burdens, the conditional payment is a fair price to pay for the results to the whole population of a sugar program."[5]

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[5] House Report No. 1179, 75th Congress, First Session, Legislative Report of July 2, 1937.

But, although Congress specifically prescribed a precise base rate of 80 cents per hundred pounds for the payments to producers who comply with the conditions imposed, Puerto Rico is here seeking to validate an application of its 5% gross income tax which would cut the base rate to 76 cents per hundred pounds. Thereby, this particular "Federal method of fostering interstate and foreign commerce and preventing ruinous competition in it" is being interfered with, or burdened, to the extent at least of depriving producers of what Congress intended should be their full and exact compensation.

Consistently with the Federal Constitution, a State may not tax the operations of an instrument employed by the government of the Union to carry its constitutional powers into operation. That principle, while not expressly stated in the Constitution, necessarily arises out of our dual government. It has often been given effect. Its application does not depend upon the amount of the exaction, the weight of the burden, or the extent of the resulting interference with sovereign independence. Where it applies, the principle is an absolute one wholly unaffected by matters or distinctions of degree. *Indian Motorcycle Co.* v. *United States,* 283 U. S. 570, 575, 75 L.ed. 1277, 1281, and cases cited therein. *Cf. Williams* v. *Talladega,* 226 U. S. 404, 57 L.ed. 275.

Petitioner fully realizes the recent restrictions of the concept "agency or instrumentality of the Federal government." Nevertheless, it is quite clear that the conditional payments, or rather the amounts received by sugar producers pursuant to the provisions of the Sugar Act, are not quite classifiable within the same tax base category as income received by individuals or firms furnishing supplies or rendering services to the United States. Certainly in these latter cases no particular statutory means or methods

are involved; no onerous conditions are to be previously complied with; no stabilization of any industry affecting interstate commerce is concerned; no legislatively devised method to foster commerce and avoid ruinous competition in it is at stake. The difference is illustrated by cases like *Kennecott Copper Corporation* v. *State Tax Commission*, 60 F.Supp. 181,[6] where the court held that certain subsidies for war production paid to a mining company by the United States, pursuant to an order of the Office of Price Administration, could not validly be included in the tax base used by the local tax commission to compute a state occupation tax of 1% of the gross amounts received by the company for ore sold. The claim made there was that the inclusion of the subsidy in the tax base interfered with the war powers of Congress and the Emergency Price Control Act by taxing the subsidy on surplus production over fixed quotas "with the result that a part of the subsidy was diverted from its sole purpose of insuring the maximum necessary production." (90 L. ed. at page 865.)

In the case at bar, the tax is sought to be laid directly and exclusively on the full amount of the conditional payments, with the obvious result that a part of the payments is thereby diverted from its sole purpose of insuring the orderly flow of sugar into the national market. Needless to say, if a state may not legitimately lay a tax of this nature, *a fortiori* a territory or insular possession of the United States is certainly in no better position to exercise that power. *Domenech* v. *National City Bank*, 294 U. S. 199, 79 L. ed. 857.

Summary of Point III

"The Puerto Rican Victory Tax Act, here attempted to be applied to conditional payments, violates the

[6] Reversed on jurisdictional grounds in *State Tax Commission* v. *Kennecott Copper Corporation*, 150 F. (2d) 905, certiorari granted 326 U.S. 711, affirmed 327 U.S. 573, 90 L.ed. 862.

equal protection clause of the Fourteenth Amendment and of Section 2, paragraph 1, of the Organic Act for Puerto Rico, insofar as said taxing enactment levies a 5% gross income tax on conditional payments received by individual sugar growers and producers while failing to levy the tax on conditional payments received by partnerships, corporations, successions, trusts, undivided joint owners, etc., and other artificial persons engaged in the same activity, namely, the cultivation of sugar cane and the production of sugar, under exactly the same conditions and circumstances. Such classification is arbitrary and not reasonably related to the objects of a statute designed to raise revenue."

Point III

The tax here involved is applicable only to individuals, defined in the act as natural persons.[7] Neither corporations, partnerships, successions, nor undivided joint owners ("comunidades")[8] are subject to the exaction. The record shows that there is a large number of such artificial entities in Puerto Rico engaged in the production, processing, and sale of sugar, and consequently receiving conditional payments under the Sugar Act. (R. 64-66.) The local tax is one that can be laid upon receipts belonging to corporations, partnerships, or other artificial persons quite as conveniently as upon those of natural persons, since it is primarily a revenue measure. It is not peculiarly applicable to individuals only.

Accordingly, we have a situation where the individual is compelled to pay the tax upon conditional payments he receives from the production and marketing of sugar, while corporations, partnerships, and other artificial entities producing and marketing sugar under the same circum-

[7] See Section 1 of the Act, Appendix.

[8] Civil Code of Puerto Rico, 1930 ed., Sections 326-340.

stances and conditions escape entirely from this tax, even though they receive conditional payments from the same source, computed at the same rates and by the same methods, and paid upon compliance with the same conditions.

It has frequently been decided that absolute equality in taxation cannot be obtained and is not required under the Fourteenth Amendment. *Colgate* v. *Harvey,* 296 U. S. 404, 80 L. ed. 299, and cases cited therein. This, of course, is not to say that, because some degree of inequality from the nature of things must be permitted, gross inequality must also be allowed. The boundary between what is permissible and what is forbidden has never been precisely fixed and is incapable of exact delimitation. Generally, the states are not precluded from resorting to classification for the purposes of legislation, and the power of the states to classify is of wide range and flexibility. *Louisville Gas & Electric Co.* v. *Coleman,* 277 U. S. 32, 37, 72 L. ed. 770, 774.

But the classification must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the objects of the legislation, so that all persons similarly circumstanced shall be treated alike. *Royster Guano Co.* v. *Virginia,* 253 U. S. 412, 64 L. ed. 989. The classification, in order to avoid the constitutional prohibition, must be founded upon pertinent and real differences, as distinguished from irrelevant and artificial ones. "Mere difference is not enough . . .", this Court has said. *Louisville Gas & Electric Co.* v. *Coleman,* supra.

The test to be applied is — does the statute arbitrarily and without genuine reason impose a burden upon one group of taxpayers (*here, the natural persons receiving conditional payments*) from which it exempts another group (*artificial entities receiving conditional payments*), both

groups occupying substantially the same relation toward the subject matter of the legislation?

Petitioner respectfully submits that the test is not here satisfactorily met. The statute itself suggests no public purpose which will be served by the exemption of artificial persons. So far as this question is concerned, the classification thus made bears no substantial or fair relation to the object of the act, which is simply to secure revenue. Petitioner has been unable to find in the statute any public purpose which can be subserved by making the taxation of income from conditional payments dependent merely upon the adventitious circumstance as to the business organization of the recipient of the payments. If there be circumstances which will justify such exemption, it is for the Legislature to point them out. To import any such circumstances into the present situation is to indulge in pure speculation. *Cf. Travis* v. *Yale & Towne Mfg. Co.*, 252 U. S. 60, 81, 64 L. ed. 460, 470. As this Court indicated in a comparable occasion:

> "To assume that some unnamed public interest exists, which will sustain the discrimination, does not help the matter here; because the assumption can rest only upon surmise, with nothing concrete or explicit appearing to support it or to indicate a legislative intent to relate the exemption to any public purpose or to anything else beyond the mere fact that the favored loans are effected within the state."[9]

This question has been squarely adjudicated by this Court and by state courts of last resort in several cases. In *Quaker City Cab Co.* v. *Pennsylvania*, 277 U. S. 398, 72 L. ed. 927, this Court held that the imposition of a tax on the gross receipts of corporations operating taxicabs, when it is not imposed upon individuals and partnerships engaged

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[9] *Colgate* v. *Harvery, supra,* 296 U.S. at page 425.

in the same business, unconstitutionally deprives corporations of the equal protection of the laws. The following language, from the opinion written by Mr. Justice Butler, is quite apposite:

> "In effect Section 23 divides those operating taxicabs into two classes. The gross receipts of incorporated operators are taxed while those of natural persons and partnerships carrying on the same business are not. The character of the owner is the sole fact on which the distinction and discrimination are made to depend. The tax is imposed merely because the owner is a corporation. The discrimination is not justified by any difference in the source of the receipts or in the situation or character of the property employed. It follows that the section fails to meet the requirement that a classification to be consistent with the equal protection clause must be based on a real and substantial difference having reasonable relation to the subject of the legislation . . . *No decision of this court gives support to such a classification. In no view can it be held to have more than an arbitrary basis.*"

The converse of the proposition has also been approved by this Court. In *Frost* v. *Corporation Commission,* 278 U. S. 515, 73 L. ed. 483, it held that an individual owner of a cotton gin who cannot do business without a franchise based on public necessity is unconstitutionally deprived of the equal protection of the laws by a statute permitting the securing of a franchise without such necessity by corporations. This Court remarked pointedly that: "A classification which is bad because it arbitrarily favors the individual as against the corporation cannot be good when it favors the corporation as against the individual." (278 U. S. 522.)

A tax similar to that questioned here was involved in the leading case of *Redfield* v. *Fisher,* 292 Pac. 813, 73 ALR 721 (cert. den. sub nom. *Fisher* v. *Redfield,* 284 U. S. 617, 76

L. ed. 526) where the court held that the equal protection of the laws is denied by a statute imposing upon individuals an annual tax of 5% upon gross income from intangibles, where corporations are not similarly taxed. It may, incidentally, be noted that the act invalidated by the above decision granted an exemption of $200 in computing the amount of income subject to tax. The Puerto Rican act taxes gross income of individuals over and above $15.05 per week.

In disposing of this point, the court below simply stated that "the classification is not unreasonable" (R. 305); that the distinction between individuals and artificial persons or associations is not unusual in the federal tax structure; and that "it is conceivable" (R. 305) that the insular legislature considered this tax as an anti-inflation device during the war period.

Such assumption, however, does not help the matter here, because it can rest only upon surmise, with nothing concrete or explicit appearing to support it or to indicate a legislative intent to relate the exemption of artificial persons to any public purpose. No doubt, inventiveness or ingenuity might possibly supply other "conceivable" bases upon which to support a pretended justification of the act's discrimination, but certainly such would be extremely weak and fanciful support pillars for an otherwise invidious classification.

The assumption that the insular legislature may have considered this taxing act as an anti-inflation device can hardly account for the discrimination. The act is made inapplicable not only to corporations but also to partnerships, successions, joint ventures, trusts, and all other artificial persons not organized in corporate form. These artificial persons, although not individuals, are food consumers in Puerto Rico. They purchase large quantities

of staple food products. Further, inflation is not limited to the field of food purchases. It presumably covers all necessary things in life. And, of course, artificial entities do purchase large quantities of items other than food products. Moreover, the act is also made applicable to nonresidents, and it is hard to understand how a tax on nonresidents can help curb local inflation. In any event, the argument that an overt tax discrimination may be justified on the ground that the statute represents a permissible legislative attempt to curb inflation through a reduction of purchasing power and standards of living, would be an easy way of sustaining almost every tax that would otherwise fall under the ban of the constitutional prohibition against arbitrary and invidious classifications.

In reality, therefore, stripped of immaterial distinctions and reduced to its ultimate effect, the statute here involved "baldly creates one rule for a natural person and a different and contrary rule for an artificial person, notwithstanding the fact that both are doing the same business . . ." *Frost* v. *Corporation Commission,* 73 L. ed. at page 489.

Accordingly, it is respectfully submitted that such classification is arbitrary because based upon no real or substantial difference having reasonable relation to the subject dealt with by the legislation.

Conclusion

The decision of the Court of Appeals, in sustaining the validity of the Puerto Rican statute's tax discrimination, deprives petitioner and all the individual growers and producers of sugar in Puerto Rico of the equal protection of the laws. It is a decision of a federal question in a way obviously in conflict with applicable decisions of this Court.

Furthermore, so far as petitioner is informed, this case presents for the first time the question as to whether a

territorial legislature may enact laws burdening or interfering with the foreign and interstate commerce in sugar as regulated by the Sugar Act of 1937. From the lower court's opinion a clear inference may be gathered that, in the absence of an affirmative act of disapproval by Congress and because of the inapplicability of the Commerce Clause to territories, the latter are free to legislate along these lines. Such holding, petitioner submits, is wrong.

This case further involves important questions concerning the administration and operation of the Sugar Act provisions relative to conditional payments, and the power of states and territories to tax said conditional payments, which have not been, but should be, settled by this Court.

Respectfully submitted,

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DARK PAGE BLEED THRU

APPENDIX

"An Act to Provide Revenues for the People of Puerto Rico Through the Levying of a Certain Additional Income Tax Which Shall be Known as 'The Victory Tax'; to Appropriate Funds for the Administration of this Act, and for Other Purposes", approved December 7, 1942 and amended May 10, 1943 and May 15, 1943. (Laws of Puerto Rico, 1943, pages 146 and 630 respectively.)

"Section 1. A tax of five (5) per cent on the gross income of every individual, in excess of fifteen dollars and five cents ($15.05) a week, for interest, rents, salaries, wages, day wages, fees, donations, compensations, remunerations, commissions, premiums, dividends, benefits in partnerships, whether civil or commercial, annuities, and any other income of whatever nature that is in cash, is determinable, and is not obtained from transactions in connection with contracts of purchase and sale in which those who receive it may have acted as contracting parties, or from reimbursements, returns of deposits, liquidations, inheritances, loans, payments on loans, and other similar operations, is hereby levied, and shall be collected and paid, in addition to any other tax levied by the Income Tax Act of 1924, and up to six months after the cessation of hostilities between the United States of America and Germany, Italy and Japan. Without this being subject to interpretation as a limitation of the terms 'salaries', 'wages' and 'day wages', the same refer also to every kind of salaries, wages and day wages paid in Puerto Rico by the Government of the United States of America. In the case of rents, there shall be deducted also as an exemption any amount actually paid as interest for liens on the property producing rent. Of the income subject to taxation by this Act there shall be deducted also as exemptions, the amounts received as compensation for labor accidents; scholarships; the sums paid by the taxpayer during the taxable year for premiums on his life insurance policies, or on the life insurance policies of his wife or children, and on insurance policies against acci-

dents, or for educational purposes, up to an aggregate insurance of twenty-five thousand ($25,000) dollars; the sums obtained or collected on life insurance policies, or on insurance policies against accidents or for educational purposes during the life of the insured, and the sums paid as compensation for cultural or artistic activities sponsored by the University of Puerto Rico or by any organization or association not for pecuniary profit. By gross income shall be understood every sum of money derived from the sources above enumerated as subject to taxation which is actually received by the taxpayer or deposited or assigned in his favor or for his benefit. The word 'payment' as used in this Act shall have also that same meaning . . ."

"The word 'individual' as used in this Act shall mean a natural person and shall include:— Residents of Puerto Rico, married or single, without application of the provisions of the Civil Code relative to conjugal partnership, and all natural persons residing or domiciled outside of Puerto Rico, whether or not citizens of the United States of America and of Puerto Rico, if these persons receive or are to receive income from any one or more sources listed as taxable under this Act, and said income is derived from causes established in Puerto Rico and the source of payment is located in Puerto Rico."

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 550

AUGUSTO R. SOLTERO,

Petitioner,

vs.

SOL LUIS DESCARTES, TREASURER OF PUERTO RICO, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

RESPONDENT'S BRIEF OPPOSING PETITION FOR CERTIORARI

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Counsel for Respondents.

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